RETIREMENT INCOME FUNDED THROUGH EQUITY RELEASE

SUBMISSION TO TREASURY

Development of the framework for

Comprehensive Income Products for Retirement

DomaCom Australia

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1 Executive Summary

Our reading of Treasury's objectives outlined in the Discussion Paper (the Paper), highlighted for us what appears to be a key assumption underlying efforts to increase superannuation based retirement incomes steams and that is that retirees will have accumulated sufficient superannuation to enable them to purchase a new annuity style product.

While this assumption will be valid for a proportion of retirees, we argue that it will not be valid for the clear majority of retirees for decades into the future.

We also argue that for many retirees, their family home represents their primary source of personal wealth and we believe it is possible to bring this asset into scope for the development of a new retirement income source.

Home equity release products have for some time been used by retirees to access funds to finance their retirement living costs. We believe that this trend will increase significantly over the coming years.

Our proposal is to link home equity release proceeds with Treasury's superannuation annuity goals by:

- developing a mechanism by which retirees can use their home equity to release funds to make undeducted contributions to their superannuation fund. These funds could then either be used to:
    - top up their account based pension product or to purchase one of the newly designed annuity products; and thereby
    - increase the prescribed, minimum annual drawdown from the superannuants account based pension or new annuity product to reflect this top up.

We believe that the existing tax concessioned superannuation regime will provide an important incentive for many retirees to use their home equity release funds to increase their retirement spending using a pension product.

2 Savings Behaviour

Ownership of the family home remains the principal wealth accumulation strategy for most Australians. Accumulating superannuation has, and will continue to be, a second place saving priority compared to extinguishing the mortgage on the family home.

This savings priority has in no small way contributed to the projected average superannuation account balance for Australian's aged between 55-64 at $321,991 for men and $180,013 for women[1].

In our view, Australian's who retire with a modest superannuation balance are more likely to view the family home as the one asset that they most want their children to benefit from when their estates are distributed.

Consequently, these retirees will do everything within their means to ensure that the family home is preserved for their children and that means having their personal financial assets last as long as possible.

In order to extend the "life" of their personal financial assets, retirees often put in place strategies that will maximise their age pension entitlements. One such strategy is to take the minimum annual drawdown from their account based pensions.

The decision to minimize their annual drawdown from their account based pension to optimise their Centrelink entitlements is also driven by a fear of the unknown i.e. how long their funds will last in retirement. We address this issue later in our proposal in section 6 titled 'Retirees and Financial Literacy'.

With many Australians retiring with more wealth embedded in their homes (equity) than superannuation, we believe that Treasury should consider steps to encourage retirees to fund future retirement incomes using home equity release in combination with the superannuation regime.

3 Retiring with a mortgage

The other significant issue that we believe will impact Treasury's retirement income policies and the development of new and innovative annuity products is the number of retirees who are expected to retire with an outstanding mortgage.

This trend is identified in the March 2017 report issued by the AIST[2] titled *"No Place Like Home: The impact of declining home ownership and its impact on retirement"*.

[1] ABS 4125.0 – Gender Indicators, Australia, August 2015

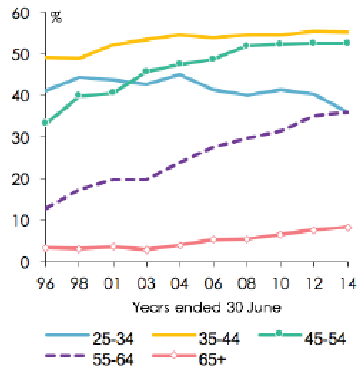
[2] Australian Institute of Superannuation Trustees

In this report, Mr Saul Eslake (the report's author) states that it is likely that:

"an increasing proportion of new retirees will use some or all of their accumulated superannuation savings to discharge their outstanding mortgage debt, meaning that a higher proportion of retirees may remain wholly or partially dependent on the Age Pension than currently assumed"[3]

His point is supported by the data presented in the table below which appears on page 10 of the report.

Chart 6B: Mortgaged home ownership rates by age group



Source: ABS 4130.0.

As can be seen from this data, the 55-64 age group shows a rapidly rising percentage of Australians that will retire with mortgage debt raising the very real prospect of large numbers of retirees using their superannuation to extinguish their mortgage.

This data reinforces our assertion that a clear majority of retirees will have insufficient superannuation at retirement to enable them to purchase an expensive retirement income product that incorporates the features suggested by Treasury. Accordingly, we believe that it is critical that Treasury consider alternative retirement income stream products that incorporate home equity release with the superannuation regime in order to achieve its goal.

[3] AIST Housing Affordability and Retirement Incomes report 2017 page 3

4 Incentives and Disincentives

Working Australians

While any capital gains realised on the sale of the family home are exempt from tax, the interest paid on a home mortgage is not tax deductible.

For most working Australians, the decision to use any surplus (after tax) cashflow to fund accelerated mortgage payments is an easy decision to make despite the incentives to make pre-tax contributions to superannuation.

Making any extra, after tax cash to make an undeducted contributions to superannuation while paying non-tax deductible interest charges on their home mortgage would make little or no sense for average working Australians.

Retirees

The disincentives to maintain their mortgage continue for most retired Australians.

Should a retiree generate a cash lump sum under a home equity release arrangement (partial release or full release i.e. sale), the retiree's funds are either:

1. spent immediately on a range of items such as:
    - extinguishing their mortgage;
    - purchase car or a holiday; or
    - provide financial assistance to their children or grandchildren.
2. deposited into a bank account for later 'consumption'; or
3. used to purchase a 'non-super' annuity assuming that the retiree is unable to make a contribution to super (under the work test rules) in order to purchase a superannuation pension.

Option 2

Under the second scenario, both the account balance and any interest earned thereon negatively impacts on their Centrelink entitlements. In addition, the interest earned may also be taxable depending on their other circumstances.

Perversely these Centrelink and taxation treatments provide a considerable incentive for most retirees to consume these funds as quickly as possible.

If these funds could be deposited into a superannuation environment however, both these disincentives would be removed under current regulation.

Option 3

Under the third, scenario the tax and Centrelink treatments under current rules are no less punitive than those for option 2.

Both the value of the non-super annuity and a portion of the annuity itself is caught by the Centrelink asset test and income tax.

5 Linking the family home and superannuation

The superannuation regime is a highly tax concessioned environment designed to encourage working Australians to save and to encourage them to fund their lifestyle using a superannuation pension in retirement.

However, for those reasons cited earlier in this submission, we believe that for most working Australians, extinguishing their home mortgage is a greater incentive than accumulating superannuation. This is particularly true when considering after-tax savings.

We believe that for Treasury to achieve its long-term goals in relation to superannuation, they need to consider affecting attitudinal (and in some cases cultural) changes to the way Australian's view their home.

Accordingly, we believe Treasury needs to consider taxation incentives that bring the family home into the overall retirement funding scope for homeowners.

This could be done by providing home owners with the opportunity to claim a personal tax deduction for the annual interest paid on their mortgage repayments.

In this scenario working Australians would have to decide whether to:

1. ***Not claim an annual tax deduction on the interest payments. This decision would then keep the family home free of capital gains tax when equity in the home is released in the future (the current situation): or***

2. ***Claim an annual tax deduction on the interest payment. This decision would then expose the family home to capital gains tax when home equity is released in the future (proposed scenario) UNLESS the home equity release is rolled back into superannuation to purchase a new retirement income stream product.***

This second option ties in with the home equity release incentive for retirees discussed below.

When faced with a home equity release event, retired Australians have little incentive to use these funds to invest in any current (or new) retirement income product. Put simply:

- Any such retirement income product would not attract any concessional tax treatments (under current regulation) unless purchased using existing superannuation savings. For reasons outlined earlier in our submission, we believe that the clear majority of superannuants will retire with too little super to enable them to fund such a purchase; and

- No incentives currently exist to bring home equity release into focus for a retiree as a source of wealth that could be used to fund their purchase of new retirement income product.

Accordingly, we recommend that Treasury consider a strategy whereby retirees can invest the proceeds from an equity release event on their home (partial or full release i.e. sale) back into superannuation provided that the following criteria is applied:

1. ***The home equity release should be limited to a property which is the superannuant's principal residence (i.e. excluding investment property);***

2. ***The contribution should be treated as a non-concessional contribution and subject to the new contribution cap ($100,000) and the maximum roll forward provisions ($300,000);***

3. ***The home equity release amount can only be deposited into a superannuation pension account (i.e. not their accumulation account);***

4. ***The retirement income pension purchased using the home equity release funds would be subject to many of the criteria put forward by Treasury for any new products including a higher minimum annual payment than the minimum rate for account based pensions.***

5. ***Retirees should be able to make additional non-concessional contributions throughout their retirement using future home equity release payments;***

6. ***When added to any earlier pension phase transfers, their superannuation 'top-up' from one or more home equity release payments can't exceed the new cap of $1.6mil;***

7. ***The existing pension commutation rules would still apply to the total sum in the super pension account.***

8. ***The existing tax and Centrelink treatments for superannuation pensions would continue to apply to any superannuation retirement income products purchased using a home equity release.***

6 Retirees and Financial Literacy

One of the most persistent challenges for the superannuation industry over the last 30 years has been to raise the level of financial literacy among financial consumers.

While much effort has been made to engage younger consumers about the importance of savings and super, only in recent years have we seen efforts to educate retirees about how long their super will last.

We agree with Treasury that the lack of answers to this fundamental retiree question is one of the principal reasons why retirees elect to receive the minimum annual drawdown from their account based pensions.

If they were confident in the knowledge that they have the financial resources to fund a higher standard of living, we are certain they would elect to draw higher annual amounts from their account based pensions.

However, in order to raise this confidence, we believe more effort is required to regulate the algorithms that underpin the long-term projection models currently used by the superannuation funds.

In an ideal environment, a retiring member of a superannuation fund should be able to enter their financial information into the projection models offered by several different superannuation funds and receive results that vary by no more than 2 years.

With this level of consistency, retirees would soon overcome their fears that they might exhaust their funds prematurely confident in the knowledge that they can afford to fund a higher standard of living in retirement.

Unfortunately, however, a quick review of online retirement projection models offered by superannuation funds reveal the following inherent deficiencies:

- An absence of a spending budgeter for living costs;

- No facility to enter any ‘one-off’ lump sum expenditures such as the cost of a significant home renovation or the purchase of a boat;
- No facility to enter recurring lump sum spending goals such as holidays, car replacements or grandchildren’s university fees; and
- No facility to enter any ‘one-off’ or recurring cash lump sums ‘windfalls’.

Spending Budgeter

Based on considerable ‘live’ experience with retirement calculators, we believe that the inclusion of a spending budgeter is critical in building trust and confidence in long-term retirement projections.

Most pre-retirees don’t know what they currently spend each year let alone what they will spend in retirement. Accordingly, the level of confidence that a retiree will have in the calculator’s output is directly related to their level of confidence in estimating their living costs in retirement.

If they have no confidence in estimating their annual living costs in retirement they will have no confidence in the projected outcomes.

Capital Expenditures

In order to further raise confidence in the output from retirement calculators, both a retiree’s planned ‘one-off’ and recurring capital expenditures should be included.

Retirement calculators should include the cost, frequency and timing of these expenses to present as realistic a projection of the retiree’s planned retirement as possible.

By including these expenditures, most retirees will immediately see that their existing financial resources are inadequate which then opens the opportunity to bring the equity in their home into the forefront of their planning.

Capital ‘Windfalls’ – Home Equity Release

Quite apart from the likelihood of a capital injection resulting from an event such as the sale of a business or an inheritance, a much greater likelihood in the future is the chance that retiree’s will enter into some form of equity release arrangement.

The inclusion of a home equity release event in retirement calculators would achieve two important outcomes.

Firstly, it would further raise the confidence that retires have in understanding how much they can spend in retirement.

Secondly (and more importantly) the inclusion of a home equity release scenario would change the 'mindset' of retirees to consider all the lifestyle funding resources available to them.

In other words, retirees would start to look beyond just their superannuation to fund their lifestyle and include the equity in their family home to determine how much they can afford to spend on living costs in retirement.

In conclusion, we recommend that Treasury work with ASIC to mandate the inclusion of the following items through changes to the appropriate regulator guides:

- ***A living cost budgeter;***
- ***Both 'one-off' and recurring capital expenditures; and***
- ***A facility to accommodate capital injections particularly in relation to a home equity release event.***

7 Home Equity Release Schemes

In section 5 of our submission, we stated our belief that purchasing an expensive annuity product (made even more so by the addition of a lifetime term and guaranteed period), will be beyond the means of the clear majority of retirees.

We also stated that Treasury can still achieve its primary goal of encouraging retirees to enjoy a richer lifestyle simply by allowing them to make post retirement, super contributions into their pension phase transfers where the source of the contribution is from a home equity release scheme.

If this strategy were to be adopted by Treasury and ASIC, we believe that in the interest of consumer protection, it is critical that any participating home equity release schemes must operate under the control, supervision and authorisation of ASIC.

Our primary reason for arguing this position is that we expect that as the baby boomers start to consume their superannuation resources in retirement, the financial services industry will quickly inundate the retiree market with different types of home equity release schemes and the regulator will need to ensure these schemes comply and that these products are not misrepresented by the advising industry when recommended. In adopting this approach ASIC can rely on its existing licensing, training and monitoring regime for financial advisers authorised to provide advice on such products.

Treasury should note that one of the largest and most publicised home equity release schemes in Australia operates outside the remit of ASIC.

The Home Safe product operated through Bendigo Bank operates as a private real estate contract between Home safe and the retiree seeking to draw down a lump sum based on the equity in their home.

While we have no view as to the veracity or value of the product, structured in this way ASIC is unable to exercise its considerable powers available to it under chapter 5 of the Corporations Act.

We strongly believe that any home equity release scheme that participates in our suggested superannuation contribution/pension arrangement should be regulated.

Accordingly, we recommend to Treasury that any home equity release schemes that participate in our suggested superannuation contribution/pension strategy should be regulated by ASIC and registered as a managed investment scheme.

8 The DomaCom Fund and Home Equity Release

The DomaCom Fund (the Fund) is a registered Managed Investment Scheme under chapter 5 of the Corporations Act.

The Fund's unique structure and platform allows for the fractionalisation of investment assets to enable the crowd funding of those assets.

Each investment asset is held in a particular Sub-Fund (represented by a class of units) by the Custodian of the Fund on behalf of investors who have been issued units in the Sub-Fund. Through this structure:

- The investment performance of an asset held within a Sub-Fund is unique to that Sub-Fund and the liabilities of any other Sub-Fund in the DomaCom Fund cannot be settled by the assets held in any other Sub-Fund; and

- Unit Holders in a Sub-Fund are entitled to receive the net income return generated by the investment Asset and a share of the net proceeds of sale in proportion to their percentage unit holding in the Sub-Fund.

The DomaCom Fund has to date secured over 30 purchases by investors through its fractional investment platform.

DomaCom's Fractional Home Equity Release

DomaCom lodged our latest Product Disclosure Statement (PDS) with ASIC in March 2017 for the registration of a Home Equity Release product. However, we have been in dialogue with the Regulator on this matter well over 4 years.

The aim of this product is to allow home owners to offer to sell a portion of their property to investors in the DomaCom Fund.

In the same way as the DomaCom Fund has successfully managed the fractional purchase of whole properties, we are now seeking approval from ASIC to manage the partial sale of a property.

In other words, a home equity release arrangement that would be unique to the market in the following significant ways:

- It is only available to home owners over the age of 60;
- The property must be their principal place of residence;
- Unlike reverse mortgage arrangements where the equity release amount is generated by issuing a loan against the home owner's property, our structure will generate the equity release amount through the partial sale of the homeowner's property.

The DomaCom is very keen to bring this product to market in the belief that it will meet a critical need that the majority of retirees will have as they exhaust their superannuation savings.

In combination with the superannuation contribution/pension strategy outlined earlier, we believe that the DomaCom Home Equity Release Scheme (and the other similar schemes that will follow) can provide the means for Treasury to extend its retirement income policy to those retirees who will retire with too little superannuation.

Accordingly, DomaCom would be delighted to meet with Treasury representatives to discuss our pending equity release product and to explore opportunities for Treasury to bring both our equity release fund and our superannuation contribution/pension strategy to the Australian retiree market.